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Geopolitical alignment, outside options, and inward FDI: an integrated framework and policy pathways

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Abstract
This paper examines the interplay of geopolitics, multinational enterprise (MNE) strategies, and host-country policies in shaping foreign direct investment (FDI) flows. We move beyond the traditional focus on MNE decisions by incorporating insights from international relations theory to analyze how geopolitical alignment influences MNE global strategies and host-country policy responses. We develop a framework that considers three main dimensions related to home and host countries: their political alignment, which affects their respective availability of outside options, and the technology gap between them and the political system in the host country. On this basis, we explore the dynamic interplay between international geopolitical agendas, MNE investment strategies, and local investment promotion agency (IPA) policy choices. Our analysis shows that while home–host geopolitical alignment can facilitate FDI and simplify policy choices, particularly in democracies, the absence of alignment necessitates a more nuanced IPA response. Our research indicates that IPA policies must consider geopolitical alignment, benefits distribution across various stakeholders, and the need to foster embeddedness and long-term engagement.

Keywords International politics · Investment policies · Technological capabilities · Political alignment

Introduction

The post-war era of geopolitics,[1] defined by the bipolar rivalry between the Soviet Union and the United States, it appeared to have run its course with the dissolution of the Soviet Union in 1991 (Fukuyama, 2015). From the early 1990s, three factors accelerated greater global integration: the widespread adoption of the Washington Consensus as the basis for economic policymaking (Gore, 2000), the rapid economic development of China, whose per capita GDP rose from (constant 2015) USD 430 in 1980 to USD 2193 in 2000, and its increasing economic integration with Western economies, especially after joining the World Trade Organization in 2001, as well as optimism about the march of democracy across the world (Eichengreen & Leblang, 2008), in particular, after the political changes in the former Warsaw Pact countries. These led to a greater emphasis on domestic institutions and how they could be shaped to maximize benefits from, among other things, cross-border trade and FDI (Daude & Stein, 2007; Levchenko, 2007).

However, in recent years, geopolitical issues have returned to the agenda, prompted by the emergence of a more multi-polar world (Beugelsdijk & Luo, 2024; Evenett & Pisani, 2023) and especially the rise of China, which has an idiosyncratic political and economic system, as a regional and global hegemon, with ambitions that challenge the U.S.

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[1] In defining geopolitics, we follow Sethi (2007): "The geopolitical context … includes the unstated, tacit, and often covert geostrategic concerns, and the national security and economic interests of countries".

and its close allies (Applebaum, 2024; Grosse et al., 2021; Kirchner, 2021).[2] Notably, while the Cold War was characterized by two dominant economic blocs that operated mainly in economic isolation from each other (Graham et al., 1992), the subsequent period, until at least 2010, was characterized by close economic integration between the U.S., China, and the rest of the world. However, these arrangements are now, to some extent, unraveling; once again, two distinct and closely aligned blocs are emerging around the U.S. and China, as is a group of more loosely aligned countries such as India and Saudi Arabia (Beugelsdijk & Luo, 2024; Clark, 2011; Li et al., 2024; Witt et al., 2023).

With these geopolitical shifts in mind, we aim to integrate insights from the international business (IB) and international relations (IR) fields to understand the framing of inward investment promotion policy choices. In the IR literature, business relations have always been viewed primarily through the lens of geopolitical tensions (Walt, 1985) and from the perspective of states rather than firms. The political and policy discussion has focused on "contentious" trade relationships between rival countries (Haim, 2016) and competition for human capital[3] and technology.[4] The Russian invasion of Ukraine and, more generally, the increasing use of sanctions as a diplomatic tool (Meyer et al., 2023) have also raised questions about what China and the U.S. are offering their international allies, militarily and politically, and how such offerings may shape the choices of third countries[5] and, by extension, the limits within which they act in the economic and political spheres (Evenett & Pisani, 2023).

In contrast, the IB literature has traditionally focused on multinational enterprises (MNEs) and how they leverage their ownership advantages (Dunning, 2000) and reduce transaction costs (Hennart & Verbeke, 2022). For example, host countries are viewed as economic spaces distinguished by institutional context (Driffield et al., 2016; Meyer & Sinani, 2009). It is, however, also acknowledged that a country is a political space (Stopford & Strange, 1992) in which politicians determine the degree of "permeability" of the country by accepting, rejecting, or modifying IB activities "by *fiat*" (Boddewyn & Brewer, 1994, p. 125), while MNEs adjust their strategies to account for the "political market for beneficial decisions" in a host country (Boddewyn, 1988, p. 351). This has been reflected in the IB literature through, for example, bargaining between host country governments and MNEs (Bhaumik et al., 2024; Eden & Molot, 2002; Mullner & Puck, 2018), and the non-market strategies of these enterprises (Sun et al., 2021). However, the implications of the new geopolitical arrangements in which two competing blocs, not to mention a considerable number of countries not closely aligned with either, coexist within a largely integrated global economy are only beginning to be analyzed in the IB literature, even as evidence about the implications of these alignments have begun to emerge from related disciplines.[6]

Some recent IB studies have already considered the implications of the growing importance of geopolitics (e.g., Beugelsdijk & Luo, 2024; Witt et al., 2023), in particular, the consequences of nationalism and how these impact MNE strategies (Lubinski & Wadhwani, 2020; Luo & Van Assche, 2023). It has been argued that the MNE's home and host countries increasingly view international trade and investment as a zero-sum game and use policy tools (e.g., related to ease of travel, subsidies, and regulatory barriers) to pursue their interests (Luo, 2023). Further, IB scholars have considered the implications of the emerging geopolitical environment for the ability of MNEs from emerging market economies to use initial investments in developed countries as springboards for greater internationalization (Fjellstorm et al., 2023; Mol et al., 2023). However, the focus in the IB literature remains on MNE strategies, taking the geopolitical context as given, rather than analyzing simultaneously the interactions between MNE choices and national geopolitical positioning, a focus which has also left discussions around country-level policies related to inward FDI mainly in the hands of economists (Van Assche, 2018). It is, therefore, timely to explore how MNE strategies and host country policies influence each other in the context of geopolitics, which is becoming increasingly perceived in terms of alignment or not with polarized blocs (Grosse et al., 2021; Witt et al., 2023) which influence the outside options of

[2] This ambition is reflected in the Belt and Road Initiative, as well as its engagement with countries within and outside the region. For example, China's outward FDI to Africa has outpaced US FDI to the continent since 2013 (Source: https://www.sais-cari.org/chinese-investment-in-africa). Similarly, by 2022, China had caught up with the US as the largest trading partner of the ASEAN nations, significantly outpacing the EU-27 countries and Japan.

[3] Brookings Institution. (2024, Jan 10). The future of the US–China competition for human capital. https://www.brookings.edu/events/the-future-of-the-us-china-competition-for-human-capital/.

[4] FP Analytics. (2021, Feb 16). Semiconductors and the U.S.–China Innovation Race: Geopolitics of the Supply Chain and the Central Role of Taiwan. https://foreignpolicy.com/2021/02/16/semiconductors-us-china-taiwan-technology-innovation-competition/.

[5] Greitens, S. C., & Kardon, I. (2024, Mar 15). Playing Both Sides of the U.S.–Chinese Rivalry: Why Countries Get External Security from Washington—and Internal Security from Beijing. Foreign Affairs. https://www.foreignaffairs.com/united-states/playing-both-sides-us-chinese-rivalry.

[6] Available evidence from the international trade literature suggests that "geopolitical alignment influences the volume of trade materially. The quarter-on-quarter trade volume grew by around 2.5% less for geopolitically distant countries relative to geopolitically close ones over the 2017–23 period, after controlling for other factors" (Qiu et al., 2024, p. 36).

the host economy. Of course, we are aware that geopolitical alignments may change over time (Erkomaishvili, 2019).

In this paper, we therefore contribute to the IB literature by integrating it with the IR literature to examine how geopolitical arrangements, specifically the choices countries make about aligning with dominant countries and blocs based on their interests (Starr & Siverson, 1990; Wilkins, 2012), affects MNE strategy. We use this framework as a basis to identify the implications for the inward FDI policy choices of the host economies. We, therefore, extend the literature on MNE–host country interactions beyond the obsolescing bargaining or Nash approach (e.g., Bhaumik et al., 2024; Eden & Molot, 2002). We develop a framework in which the outside options of MNEs and their potential host countries depend on the geopolitical alignment of country dyads. This enables us to introduce discussions about MNE–host country interaction, an element influenced by host countries' political, security, and military needs. On this basis, we can also contribute to the classical discussion in the IR literature about how countries balance their domestic politics with their international relations (Putnam, 1988) and to the emerging discussion in the IB literature about how a host country's foreign policy, as reflecting its geopolitical alignment, strikes a balance between its economic interests (served by MNE inward investments) and the interests of domestic veto players (Andrews et al., 2024). Based on this sequential game between MNE and the host economy, we consider how these political (national alignment) and strategic (MNE FDI options) affect the framing of policies by the host country IPA. We highlight how these are contingent on two significant factors: the technological gap between the home and host economy and the political system in the host economy. The former helps identify the benefits the host country might expect from the FDI. At the same time, the latter, specified along a spectrum from democracy, specifies the preference of the host country in terms of the distribution of those benefits.

Our paper progresses in four stages. First, we discuss the implications of a specific element of geopolitics: the evolving alignment (or not) between dyads of nations. Second, we explore how such alignments may influence MNE strategies, drawing on the IB literature about the legitimacy of MNEs in host countries and the factors that affect that legitimacy. Turning to policy, we first consider what these MNE strategies, and therefore the changing geopolitical environment, imply for the inward FDI policies of host countries. We analyze how IPA policy choices are contingent on the technological gap between home and host countries and the political system in the host economy. We conclude by reflecting on the implications of this work for future research.

Geopolitical alignment and its implications

The nature of geopolitical alignment

We start by focusing on geopolitical alignment, the idea that countries associate with each other politically, economically, and perhaps militarily because of shared interests, values, and security concerns. In the post-World War II period, such alignments were mainly viewed through the prism of the Cold War between the U.S. and the Soviet Union: "[t] throughout the Cold War, Europe was divided by political, military and cultural barriers between the Soviet-dominated East and the capitalist democracies of the West."[7] This dichotomy was also reflected in discussions about the relationships of these global powers with countries in the developing world (Fukuyama, 1985). However, the reality was always more complex: the non-aligned movement (NAM) started in 1961, and in practice, both alignment and non-alignment with the two superpowers were led by national self-interest, sometimes by domestic imperatives and sometimes by external threats. Even so, it has been argued that "[n]on-alignment during the Cold War never meant not taking sides. Within a year of founding NAM, Nehru turned to the US for assistance in the Sino–Indian War. A decade later, Nehru's daughter, Prime Minister Indira Gandhi, turned to the Soviet Union for *help*. Egyptian President Anwar El-Sadat famously "dumped" the Soviets for the Americans in the early 1970s."[8]

In the post-Cold War era, after a period of unilateral U.S. dominance, the rise of China in world manufacturing and trade and its competing political and economic system once again led to increasing focus on alignment with one or another of two global powers. However, many countries also recognize that emerging economies, in particular, prefer a "less-than-clear" alignment with the U.S. or China (Afzal et al., 2023) and a diversity of relationships.[9]

[7] Campos, R., Heid, B, & Timoni, J. (1 July 2024). The economic consequences of geopolitical fragmentation: Evidence from the Cold War, Vox EU/CEPR, https://cepr.org/voxeu/columns/economic-consequences-geopolitical-fragmentation-evidence-cold-war.

[8] Woods, N. (2022, Oct 26). In defence of non-alignment, Blatvanik School of Government, University of Oxford, https://www.bsg.ox.ac.uk/blog/defence-non-alignment.

[9] Indeed, countries such as India are increasingly working with multiple powerful countries; for example, India has strengthened its military relations with the US and remains part of the QUAD while maintaining a close relationship with Russia and engaging with China via the Shanghai Cooperation Organization and BRICS. As a consequence, there are increasing discussions about "multi-alignment" in the domain of geopolitics and international relations. See, e.g., Baker, R. (2024, April 29), Examining multi-alignment in the Asia-Pacific, *Stratfor*; Kavanagh, J., & Wehrey, F. (2023, July 17), The multi-aligned Middle East, *Foreign Affairs*. The arguments put forward in this paper, however, are not materially impacted by distinction, if any, between (new) non-alignment and multi-alignment.

Simultaneously, the rise of countries like India, which has become a significant economic and military power, or Russia and Brazil have added to the complexity of an increasingly multipolar world. For example, in 2021, the export share of Germany to the U.S. (8.84%) was only slightly larger than its export share to China (7.56%) despite Germany being a staunch U.S. ally and fellow NATO member country.[10]

It has been hypothesized that political similarity is important in shaping alignment through alliances between states (Lai & Reiter, 2000; Simon & Gartzke, 1996).[11] The key rationale is that even though there may sometimes be tolerance for political differences, states are more likely to align closely when they share political systems. This has been a popular topic in IR theory since the pioneering works of Wendt (1992) and Doyle (1983), who identify that shared norms, values, and identities and the value that countries attach to democracy are important for explaining alignment. The close web of relationships between Western Europe and the U.S. is an example, founded on a shared commitment to democracy and rules-based domestic and international orders.[12] This highlights the nuanced reality of geopolitical affiliations despite historical alliances.

Alliances, institutional divergence, and MNEs

There is increasing evidence to suggest that geopolitical alignment has significant economic implications. It has been argued, for example, that countries voting with the U.S. in the UN are better treated by the IMF (Reynaud & Vauday, 2009). More recently, using voting patterns of countries in the UN, Qiu et al. (2024) have demonstrated that over the 2017–2023 time period, quarter-on-quarter trade volumes grew 2.5% less for geopolitically distant countries than for those closer. Available evidence also suggests that closer geopolitical proximity between countries can increase the use of the euro and renminbi among countries, especially for emerging market economies and developing countries (Koosakul et al., 2024). FDI patterns have been affected as well. Scholars have argued, for example, that geopolitical alignment influences the location choices of MNEs, with bilateral investments affected by the geopolitical alignment of countries (Adarkwah et al., 2024; Aiyar et al., 2024; Javorcik et al., 2024).[13]

These FDI patterns are also influenced by moral suasion or regulatory steps taken by home country governments. Thus, China and the U.S. increasingly expect firms from their own or closely allied countries to be wary of trade or investment in the rival block, especially in sectors considered to have strategic or military significance (Beugelsdijk & Luo, 2024; Meyer et al., 2023). In addition, divergence in alignment between the home and host countries of MNEs can influence FDI by increasing the political risk of operating in the latter. An MNE may, if it invests in a host country that forms part of an alliance opposed to the home country, find itself open to a range of difficulties, ranging from investment screening, export controls, consumer opprobrium and poor press to extreme measures such as expropriation of assets or being subjected to sanctions (Meyer et al., 2023). A more profound implication is that countries that are not aligned with each other may experience divergence in their institutions, especially if they view the world through the lens of a zero-sum game (Meyer & Li, 2022), as we see in the evolution of U.S.–China rivalry (Li et al., 2022a, b).

There is a rich IB literature on the implications for MNEs of institutional distance between dyads of countries (Kostova et al., 2020). For example, it has been argued that the interplay between an MNE's competitive advantage, strategy, and organizational diversity can influence its location choice. In contrast, the nature of the institutional distance—cognitive, normative, or regulatory—can influence the MNE's choice of mode of entry to a host country (Xu & Shenkar, 2002). Indeed, institutional distance has been suggested to be a key driver behind the liability of foreignness (LOF) (Eden & Miller, 2004), which, in turn, is a key driver of the social cost of the MNE's operations in a host country.

A specific source of LOF is the MNE's relative lack of legitimacy in host countries (Kostova & Zaheer, 1999), in that local stakeholders may use criteria to evaluate MNEs and their products that differ from those used to judge local companies. IB has focused on institutional distance in terms of internal institutions and local property rights protection. However, it is easy to envisage how geopolitical alignment (or its absence) can impact the legitimacy of an MNE in a

[10] Source: https://wits.worldbank.org/CountryProfile/en/Country/DEU/Year/2021/TradeFlow/Export.

[11] It is important to note that some scholars have distinguished between the multifaceted construct of alignment and the more traditional construct of alliance, which focused largely on the military dimension of inter-country relationships (Wilkins, 2012).

[12] Alignments can also be shaped by common interests but not underpinned by common values. Using the "balance-of-beliefs" paradigm, Feng and He (2024) have argued, for example, that while President Xi and Putin share interests and perhaps also ways to strategize about achieving their goals (e.g., about reducing U.S. dominance in the world order) they have significantly different world views and values, so their alignment is probably largely interest-based.

[13] A September 2023 Bloomberg report highlighted that "data points to a world reorganizing into rival—though still linked—blocs that reflect UN votes on Russia's invasion of Ukraine. Of the $1.2 trillion in greenfield FDI invested in 2022, close to $180 billion shifted across geopolitical blocs from countries that declined to condemn Russia's invasion to those that did." Source: https://www.bloomberg.com/graphics/2023-geopolitical-investments-economic-shift/.

host country and exacerbate the problem of LOF, though, as Andrews et al. (2024) note, this is seldom explored. For example, Zaheer (2002) argues that in the post-9/11 world, the LOF of MNEs from some parts of the world, such as the Middle East, may have increased in certain host countries (e.g., the U.S.) in part by adversely affecting the legitimacy of these firms. If an MNE continues with operations in a host country despite geopolitical divergence between the host and the MNE's home country, it may have to absorb any resulting increase in the cost of doing business and/or any negative impact on its revenue.

Therefore, changing geopolitical factors can influence an MNE's ability to balance its internal legitimacy (within its network) and external legitimacy within a specific host country context (Chan & Makino, 2007). This is recognized as a "delicate balancing act" in the best of circumstances (Meyer et al., 2011, p. 245; Saka-Helmhout et al., 2016), as evidenced by the related literature on how MNEs use social activities to manage their legitimacy in host country contexts (Rathert, 2016). Extant research also suggests that MNEs leverage their connections with respective home country governments to reduce their LOF in overseas locations, though such non-market strategies can be expensive (Huang et al., 2024). It might, therefore, be wise for an MNE to strategize ex-ante while choosing the location for its operations rather than attempt post-entry management of its legitimacy once operations are underway. We next build on the literature on the mutual interdependence of states and MNEs (e.g., Bhaumik et al., 2024; Stopford & Strange, 1992) to develop a bargaining model which explicitly considers the co-evolution of geopolitical alignment, MNE strategy, and host country inward investment policy.

MNE–host country interaction in the context of geopolitical alignment

Since Stopford and Strange (1992), much literature has emerged on MNE–host country bargaining. This primarily focuses on two different elements of this bargaining process. The first concerns the relative bargaining power of the two parties (Boddewyn, 2016; Eden et al., 2004), where the source of the power imbalance may lie in factors such as (quasi-) monopoly control over resources and technology (Kobrin, 1987), resource complementarity between host country resources and ownership advantages of the MNE (Luo, 2001), timing of the MNE's entry into the host country (Eden & Molot, 2002), and the relationship between the MNE and its home country government (Li et al., 2013).

Second, a key theme of this literature is obsolescing bargaining, a form of a hold-up problem. Specifically, before an MNE invests in a host country, it may require assurances from the host country government about access to markets and resources and policies around trade and taxation, and, in return, the host country government may require assurances about factors such as technology transfer by the MNE (Eden et al., 2004). At this point in the negotiation, the MNE may have much stronger bargaining power, for example, because of its access to superior technology, and the host country government may, consequently, make several promises or offer several concessions to secure the investment. However, once an investment has been made, the MNE has sunk assets in the host country, making withdrawal from the country complex expensive. In this second stage of the game, the two parties' relative bargaining power has changed, allowing the host country's government to renegotiate the terms of the agreement, for example, reneging on the previous concessions. An extension of the obsolescing bargaining framework is a two-tier bargaining process (Ramamurti, 2001) whereby, in tier-1, agreements are reached about mechanisms to reduce the host country's opportunistic behavior (e.g., investment treaties).[14] At the heart of these models is bargaining between the MNE and the host country government about the scale of the MNEs inward investment and the state's offer of financial and other inducements.

In these models, the behavior of the MNE is considered in depth, but the objectives of the state are not well developed. This leads Bhaumik et al. (2024) to introduce the objectives of host country governments, which are argued to depend on the political system of these countries. They argue that the payoffs of the political elite who form governments are generally weighted sums of the welfare of the citizens and their own private benefits. They go on to contrast democracies, where political power is contested, and greater weight is attached to the former, with autocracies, where greater weight is attached to the latter. They recognize that this is a simplification in that political systems can be viewed as lying along a democracy–autocracy continuum. Moreover, some autocratic states prioritize general welfare improvement, while democracies may sometimes emphasize the welfare of political or economic elites over that of the general population. However, empirical evidence suggests that such simplification is not unwarranted (Goldberg & Maggi, 1999; Mitra et al., 2002).

Based on its objective, given by the political system, a host country's government will attempt to generate rents through controlling factors such as resources, markets and policies that affect an MNE, as described above. However, the distribution of this rent now depends on the political

[14] The literature has also seen a rise in discussions about non-market strategies of MNEs that involve interactions with host country governments post-entry, often with the objective of mitigating LOF, especially when the MNEs are owned by emerging market governments (Cuervo-Cazurra, 2018; Mahini & Wells, 1986; Mbalyohere et al., 2017; Meyer et al., 2014; Rajwani & Liedong, 2015). However, as we argue later in this section, that conversation in the literature is not germane to our narrative.

system because, as Bhaumik et al. (2024) show, this determines the relative importance of citizens' welfare and private benefits for the political elite. Moreover, the wish list of the host country government may include the transfer of technology by the MNE, investments by the MNE in specific locations, and engagement with domestic companies by way of supply chains. On the other side of the bargain, the MNE will want, for example, the host country's government to grant it preferential access to resources and markets, to invest in appropriate infrastructure, to implement favorable policies, and, more generally, to take actions that create or improve locational advantages of the MNE. Bhaumik et al. (2024) formalize such bargaining using the Nash framework (Nash, 1950) that considers the MNEs and host country governments' outside options. For example, the outside option for the MNE is the return it will earn by investing in the next-best available location. Similarly, for the host country government, the outside option is the return it would obtain by diverting the resources initially set aside in proposed policies for the MNE to the next-best investor (foreign or domestic). In their proposed model, therefore, bargaining power is endogenous, depending on the outside option for each party.

We build on this framework by exploring how geopolitics affects bargaining; in particular, home and host country alignment or non-alignment is important; however, it is important to note the boundaries of this analysis. Geopolitics will not influence this narrative if the host country is geopolitically passive, in the sense that it is not significantly aligned with any world power, so the additional LOF for MNEs and the red lines for host countries (e.g., Chinese 5G equipment in the U.S. and its allies) that are created by geopolitics are not part of the consideration. Such cases might include, for example, small, resource-poor, less developed economies in geopolitically less sensitive regions such as Bolivia, Cameroon, or Laos. In this situation, MNE–host country interactions would arguably be characterized by the Nash bargaining model, with the relative bargaining power of the two parties determined by their respective outside options. Similarly, if we consider FDI among groups of aligned countries, e.g., the U.S. and European countries, where geopolitics-induced LOF is not an issue, MNE–host country interactions can again be modeled along the Nash bargaining framework. Finally, where an MNE or a country has (near) monopoly control over a technology or a resource, respectively, the interaction between the MNE and the country would become a special case of the Nash bargaining framework, and their interaction can be modeled accordingly.

For the remaining cases, however, different degrees of geopolitical alignment (or divergence) must be introduced into the picture, and this fundamentally changes the narrative; an MNE must now consider the trade-off between locational advantages of a host country, for example, by way of access to resources and markets, and the LOF associated with a geopolitical divergence between its home country and a potential host country. At the same time, geopolitical divergence may restrict what a host country can offer MNEs to help overcome the geopolitics-induced LOF. Notably, the implications of LOF for an MNE's global strategy and its performance are likely to be a source of informational asymmetry, with the MNE having private information on the matter that is unavailable to potential host countries. Similarly, while the broad contours of a host country's red lines on account of its geopolitical alignment may be known, how much of a concession the host country is willing to make for a specific MNE's investment may involve private information not fully known to the MNEs. Finally, unlike in a Nash bargaining model, in which choices are made by the two parties simultaneously, the policy package offered by a potential host country and the location choice made by an MNE is likely to proceed sequentially. We, therefore, need to develop a new framework to capture MNE–host country interaction in this context.

Drawing on Kosenko et al. (2023), we propose that the MNEs and a potential host country engage in a game that proceeds as follows. First, the MNEs will reveal the nature of their project, e.g., the investment size, the technology embedded in the project. Next, potential host countries will reveal specific details about their inward FDI policies, including what they are willing to offer to an MNE and its conditionalities. The policy choices will be informed by the outside options of these countries, given the MNE's disclosures about its set of potential investment projects globally, and the capacity of domestic firms in these countries to deliver similar projects. These choices will also depend on the political systems of these countries and, by extension, the relative importance of citizens' welfare and private benefits to the political elites of these countries. For each MNE, the disclosure of FDI policies made by the potential host countries would help identify the optimal investment destination. It would also help characterize its outside options as it trades off the concessions and conditionalities offered by the potential host countries with geopolitics-induced and other LOFs. The location choice by the MNE follows. The direction of the causality implicit in this game, which runs from host country policy choices to MNE location choices, is consistent with the discussion in the IB literature (Chen et al., 2010). Our analysis, therefore, implicitly draws on the conclusion of what is effectively a multi-stage sequential and non-cooperative game. The key consideration in this game is the choice of FDI policies by host countries, which sets the context for the bargaining between the host country and the MNE.

Consistent with the literature on FDI location strategy, this is initiated by the firm making an FDI decision and either implicitly or explicitly deriving a set of potential locations. Next, the policymakers, in this case, the investment promotion agencies (IPAs), develop both national and local strategies to entice the MNE on the understanding that their location can attract this firm's investment and that the benefits are sufficient to justify their commitment to resources. The parameters for these may be set by a wider government policy agenda, including for example ministries of finance, labor, science and technology, or regional development. The approach therefore proceeds in two parts. The first is the development of approaches to attract FDI, which may or may not be communicated to the firm. The second is the communication of this strategy to the broader audience. For example, an IPA may focus on attracting FDI in specific sectors or in activities aligned with local strengths. The extent to which this is communicated to a given set of investors is determined by the considerations of geopolitical alignment and technological difference (driving the benefits from FDI), along with an understanding of the firm strategy and the specific offers that an IPA is willing to make to MNEs what it seeks in return are influenced by its development objectives—employment, technological spillovers, etc., in the domestic context. Third, MNEs communicate these outside options explicitly and choose the optimal location as the outcome of a bargaining process influenced by the outside options of both parties (alternative locations and alternative investors), the relative technology level of the firm and home country, and the economic objectives of the prospective host countries. The final stage is where, once the firm has selected the location, policymakers seek to maximize the benefits of that investment based on the aforementioned economic development objectives;[15] such that the decisions taken at this stage are, in part, a feature of the nature of democracy in the country. This framework is summarized in Fig. 1.

In the subsequent sections, we discuss policy responses of host countries/IPAs that maximize the likelihood of attracting FDI, given their internal political and external geopolitical constraints, and the policy responses aimed at maximizing the benefits associated with inward FDI.

Potential policy responses for attracting investment

IPAs offer a standard basket of incentives to attract FDI, which are widely recognized in the literature (for a detailed discussion of this literature, see Crecenzi et al. (2021)). One can characterize these as either incentives to de-risk investments, to overcome location disadvantage, or more focused interventions to help firms establish legitimacy or overcome LOF. These amount to various incentives associated with capital spend, whether capital grants, tax incentives, or a subsidy (sometimes 100%) towards land purchases. In addition, there are incentives based on the nature of the activity, such as waiving import restrictions, additional support for R&D, incentivizing knowledge transfer from abroad, or direct subsidies based on employment or exports. These can be sectoral level, with incentives available explicitly for certain activities, targeted at the firm's level, or even at the individual level—the so-called "golden visas," for example. They typically require collaboration between those responsible for inward investment promotion and other government agencies, such as the Ministry of Finance or, in the case of visas, those responsible for immigration. However, we focus in detail on the policy choices that face IPAs, considering differences in alignment, the domestic political environment, and the technology differences between the host location and the MNE.

IPAs use a fishing analogy when they discuss inward investment attraction: MNEs are "landed" as foreign investors. As discussed in Fig. 1, once MNEs reveal the nature of their projects and the associated investments, these IPAs become aware of their outside options as they are able to evaluate alternative investments, and the benefits they may yield, in terms of technology, employment and exports. At this stage, however, the MNEs are still unclear about *their* outside options that eventually influence their choice of location. Our framework allows IPAs from potential host countries to influence the outside options of MNEs by adopting and announcing their strategies concerning inward FDI policies, which can help mitigate the LOFs that MNEs may experience on account of any geopolitical divergence between their home and (potential) host countries. To continue with the fishing analogy, an IPA knows which seas (or ponds) it can fish in, how good the fish will be when they are caught in terms of size and quality,[16] how complex the fish will be to land, and the

[15] In effect, therefore, the choice of optimal FDI policies is decided by backward induction. Even though the benefits of any MNE investment in a host country are realized *after* its IPA announces its offers and expectations from inward investment, the offers and expectations themselves are predicated on anticipated benefits.

[16] For simplicity, we can classify this into one of four categories: to maximize FDI flows (in dollars); to maximize knowledge flows into the country; to generate employment; and to maximize spillovers. The relative importance of these four outcomes for the host country government will influence its policy response, in particular, about the scale of the incentives that may be offered to a given investor.

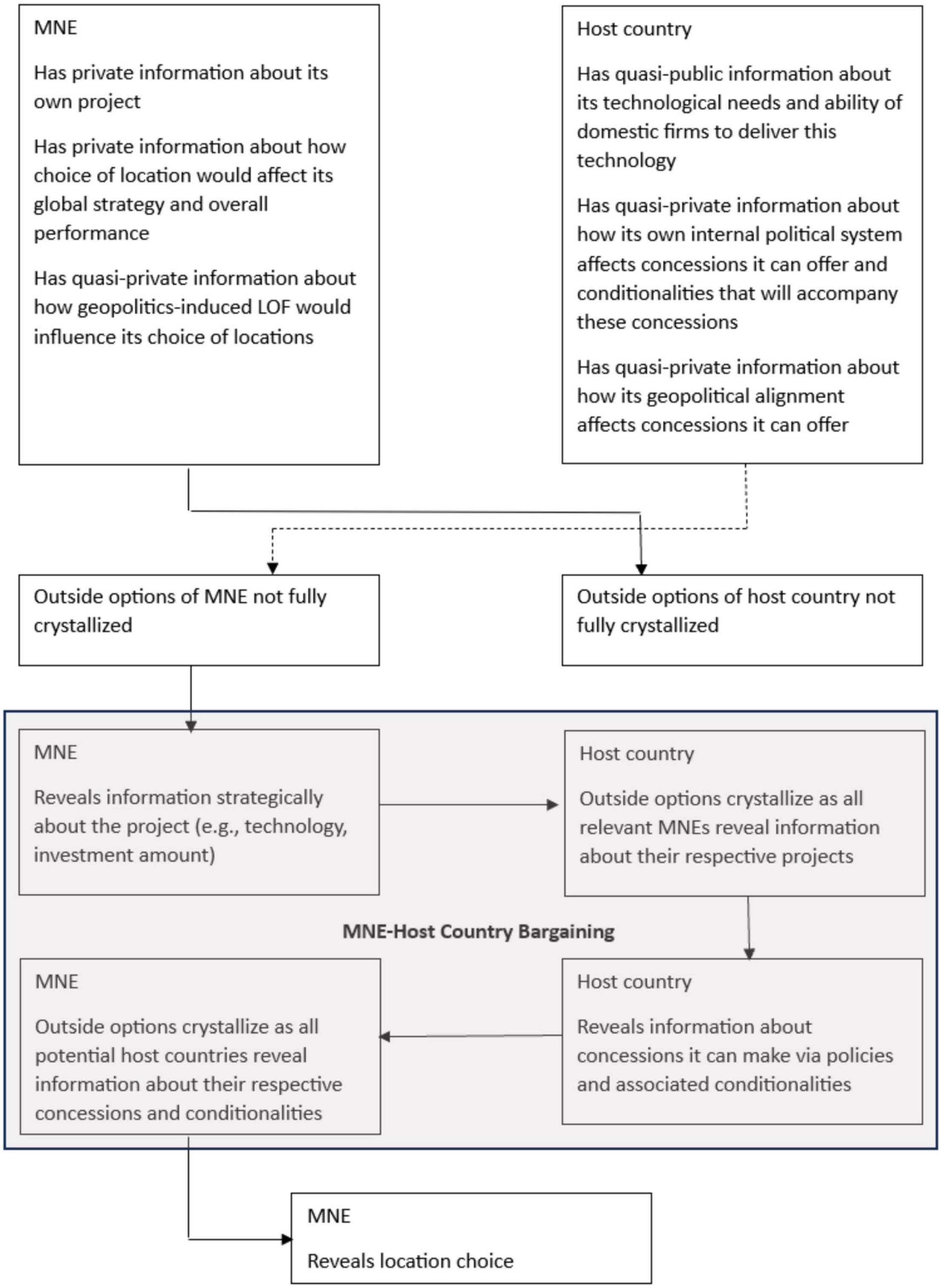

Fig. 1 MNE–host country bargaining

size of the fish's teeth. Collectively, these considerations, including outside options, an IPA can determine the nature of the investment promotion package that is required to land a given investment.

We also propose that host country IPA strategies are likely influenced by the country's institutional quality and internal political system. For example, it has been argued that countries with a better rule of law are likely to offer fewer tax incentives and that this effect is more substantial for democratic countries (Li, 2006). The rationale for this lies with the greater protection that countries with better rule of law can offer to the intellectual property (IP) of the MNEs and the role that multiple veto players[17] play in democratic countries to offer a credible and consistent policy environment for FDI (Jensen, 2003). Further, while there may be resistance to the market power of MNEs in a host country (Li & Resnick, 2003), changes to FDI policies that reduce FDI and, by extension, the creation of high-quality jobs and economic growth are likely to face strong electoral backlash in democracies (Choi & Samy, 2008). Indeed, it is interesting to note that the backlash against globalization in countries such as the US is not affecting the pitch for inward FDI into the country. By contrast, countries with high political risk where regime changes can be sudden and stochastic may need to offer greater incentives to MNEs. It has been argued, for example, that resource-rich countries may offer cheap access to resources to overseas investors (Hajzler, 2014).

These IPA strategies are also likely to depend on country-specific factors and the political economy of the host country. For example, countries with relatively large internal markets can be expected to offer less fiscal benefits (Haufler & Wooton, 1999).[18] Similarly, unionizing workers in a host country may induce it to offer greater incentives to MNEs to compensate them for higher union wages and, more generally, higher labor costs (Haufler & Mittermaier, 2011). A host country's ability to offer incentives may also depend on whether the industry is security-sensitive[19] or economically distressed and whether a host country company experiences high entry barriers (or LOF) levels in the home country of the MNE.[20]

As mentioned in the previous section, FDI policies are typically set by central governments and delivered by local or national IPAs. As such, geopolitics may affect FDI policies of host countries in two different ways. First, since geopolitical divergence between its home and host countries increases the LOF of MNEs, it may be necessary for a host country that seeks investment from an MNE from a geopolitically divergent country to offer greater incentives to the MNE. At the same time, it may not be politically easy or feasible for a country to offer fiscal and financial incentives to MNEs from geopolitically divergent nations—it may be politically expedient to only engage in investment treaties with specific sets of countries or to only offer "golden visas" to citizens of geopolitically aligned countries, which is consistent with the evidence about geopolitical fragmentation in FDI flows (IMF, 2023). Further, even if host countries attempt to alleviate LOF of MNEs from geopolitically divergent countries to ensure that the property rights and IP of these companies are protected, not all countries have equal agency in designing the preferred mechanism to ensure these outcomes, namely, bilateral investment treaties (BITS). Available evidence suggests that the relative power of countries plays an important role in shaping the nature and enforcement mechanisms of these treaties (Allee & Peinhardt, 2014). Interestingly, FDI policy may not just aim to mitigate the LOF arising from geopolitical divergence but may also be a tool to create geopolitical alignment. For example, Guyana arguably made greater concessions to ExxonMobil than they could have to other MNEs in the sector to strengthen security ties with the U.S. and thereby have a counterbalance against a regional power (Krane, 2022).

By way of focusing on the concessions that host countries' IPAs can make to attract FDI and the factors that influence these concessions, this section implicitly focuses on the benefits associated with FDI, namely, capital and technology flows, spillovers that benefit domestic firms and supply chains in the host country, export growth, and high-value employment generation. However, in the discussion, we also allude to the fact that incentives or concessions made to the MNEs to attract such investment also depend on the priorities of the host country government or IPA and that, in turn, may significantly depend on the nature of the projects on offer, as well as on the political orientation of the government, i.e., its focus on the benefits accruing to citizens relative to those accruing to the political

[17] As such, it can be argued that veto players make it difficult for special interest groups to consolidate political and, consequently, economic power (Gehlbach & Malesky, 2010). A corollary of this is that in a democracy where the government is accountable to Parliament, the judiciary, and the wider civil society (meaning that power is not concentrated in the political elite that rules the country at a given point in time), there are multiple veto players. However, it has been argued that with the rise of veto players, countries may find it difficult to enter into preferential trade arguments (Mansfield et al., 2007), and the current experience of countries such as the U.S. suggests that this is on account of concerns about local employment (or the loss of it). In other words, a rise in veto players may be associated with policies emphasizing direct and visible benefits for the citizens who constitute the largest set of veto players in a democracy. Citizens may, of course, be ideologically divided such that the pressure they can put on the government to introduce or adopt policy measures that enhance their welfare is reduced (Ha, 2008), but it is reasonable to argue that the connection between veto players and the focus on employment and economic opportunities for citizens is not completely lost.

[18] We deliberately abstract from potential complexities such as coordination among countries that can facilitate coordinated tax increases to shift rents from MNEs to the countries (Haufler & Wooton, 2006).

[19] For the related discussion about FDI screening on the grounds of, among other things, national security, see the Investment Policy Monitor (Issue 25, Feb 2023) published by UNCTAD https://unctad.org/system/files/official-document/diaepcbinf2023d2_en.pdf.

[20] See Pandya (2016) for a related discussion.

elites in these countries. For example, many inward investment incentives (e.g., tax benefits, subsidies, reduced import duties) are linked to specified forms of technology transfer, local content requirements or mandated partnerships with local companies. As such, the observed concessions made to MNEs to reduce their geopolitics-related and other LOF depend on the payoffs to the electorate and the political elite that are expected to follow from the FDI projects.

Further, this requires the coordination of policies at local and national levels, not to mention the competing claims of potential locations *within* a host country, which depend on the political orientation. In democracies, especially those with high levels of devolution and which, therefore, have a significant number of veto players, inward investment attraction is often associated with job creation, and policymakers must be mindful of economic opportunities for the electorate. This sometimes leads politicians to prioritize FDI volume over benefit, and as a result, they "overpay" in order to attract it. It is necessary, however, to identify these effects in context, and this is something to which we return below. For example, take the case of the UK, which has what one might consider to be an evolving set of alignments. The combination of a high degree of geopolitical alignment with a specific bloc and its impact on the LOFs of MNEs from rival blocks and which may curtail the ability of the country to act unilaterally with regards to policies to attract FDI, the need to attract investment to lagging regions, and the need to attract technology significantly curtail the UK's outside options for IPAs, shifting the bargaining power to the overseas investors.

We can see, therefore, that while IPAs may, in principle, rely on a number of policy initiatives to attract FDI, the choices that they can make are ultimately influenced by the nature of a country's geopolitical alignment. This is most notably the case where a country is in a formal trade block or a common market with its geopolitical partners; For example, incentives may fall foul of jointly agreed state aid rules. Ultimately, IPAs must navigate complex relational dynamics to effectively enhance their bargaining position while delivering tangible economic benefits to their citizens. In the next section, we discuss how IPAs and the associated host countries decide on their economic objectives and priorities that ultimately crystalize as benefits, and those that underpin their FDI policies in the interim.

Setting the boundary conditions for bargaining: Host country priorities

As discussed in the previous section, the political system of a host country influences the outcomes of FDI projects that the country's government favors and, by extension, the offer that it is willing and able to make to attract certain types of projects. We, therefore, begin with a discussion about how a host country decides about this offer and what it wants in return from the MNEs (or FDI projects) as part of the bargaining process (Fig. 1). The starting point is the proposition that democratic and autocratic governments attach different relative weights to the welfare of the citizens and the private benefits of the political elite (Bhaumik et al., 2024). Host countries closer to the autocratic end of the spectrum may well attach importance to the welfare of their citizens, but by the very nature of their political systems, they are (relatively) unconstrained by veto players. Not surprisingly, therefore, much of the discussion about the priorities of host country governments about FDI outcomes has focused on countries closer to the democratic end of the spectrum.

The importance of democratic accountability in influencing FDI policy has been explored in several domains, including political science, regional policy, international economics, and international business. A common strand one can identify is that democratic countries are more likely to prioritize employment creation over other concerns, such as productivity. For example, Ahlquist (2006) and Pandya (2016) both argue that in democratic countries, inward investment policy is skewed towards employment generation.[21] More broadly, the political science literature focuses on how policies towards FDI can better reflect the prevailing view of the electorate. This includes, for example, in the case of developing countries, the electorate demanding specific labor standards in inward investors or guarantees concerning the sharing of resources or over social welfare (Li & Resnick, 2003). Similarly, Rodrik (2008) explores this issue in a broader setting, considering how inward investment strategy may reflect a society's desire, for example, to address unemployment in specific locations rather than to maximize economic growth.

The implications of a democratic political system for formulating FDI policies also depend on the *layers* of democracy, specifically, the extent to which political power is devolved to states or regions within a host country. This is important because in a democracy with multiple veto players, which are often (but not always) spread spatially across regions, political leaders must consider the presence of those veto players and the collective welfare of its citizens when formulating inward FDI policies. Put differently, the

[21] This presents an interesting conundrum at the time of writing, where the richer countries demonstrate wide variations in their willingness to adopt more flexible labor markets, and where this is mooted, as in the case of France, has been met with a high level of hostility. In general, however, one could argue that Europe, in particular, does not have an unemployment problem so much as it has a productivity problem, and as such, FDI policy should be more concerned with growing productivity rather than employment, while regional policy is still concerned with regional disparity rather than productivity (Christou et al., 2024).

presence of these veto players may force the government to weigh the welfare of different regions and different sets of economic agents differently and consider the private benefits of the local and regional elites. The challenge is further enhanced by the difficulty associated with policy coordination in contexts where political power is devolved (Bolleyer & Borzel, 2010), and sub-national veto players may promote region-specific policy initiatives (Immarino, 2018).

Understanding the factors that underpin how the host country would prioritize specific FDI projects, thereby defining its outside options, as well as the nature and extent of its value proposition to MNEs in order to overcome their LOFs, requires a framework that brings together the technological needs of the country, the political system in the country and, in the context of this paper, the geopolitical alignment (or divergence) between itself and the home countries of potential investors.

Our starting point is that typically, whether at the level of the firm or the level of the individual, the beneficiaries from the effects of attracting FDI are those with higher levels of physical, intangible, and human capital. For example, firms with appropriate spillovers have higher absorptive capacity levels (Castellani et al., 2024), while inward investment typically increases the demand for more skilled workers (Becker et al., 2020). Similarly, more productive firms with higher levels of firm-specific assets are better positioned in value chains operated by MNEs. Therefore, to maximize the welfare effects of FDI attraction, policies need to reflect this and consider the economic development objectives of the government. One also needs to understand the spatial nature of the gains, namely, whether they accrue locally, perhaps to already prosperous areas, or are spread more evenly throughout the economy.

The emphasis here is to move from a framework which seeks to maximize inward investment flows into a country to a more nuanced understanding of how the focus on benefit maximization from these flows may, for different combinations of technological needs, domestic political systems and degrees of geopolitical alignment, influence the objectives of a host country government.[22] The most basic distinction, which is linked to the motive for the investment, is between FDI that has high levels of embedded technology, with the potential for spillovers and increases in demand for skilled workers, and efficiency-seeking FDI—for example, assembly operations—that may have limited spillovers and hence limited impact on productivity but a significant impact on low- and medium-skill employment (Driffield et al., 2009). The discussion earlier in this section gives us an idea about how the choice of a host country's government may depend on the political system in the home country. However, as we discuss later, the final choice may also depend on the choices made by the MNEs, e.g., the extent of technology transfer that has implications for spillovers. As we demonstrate below, this requires a more nuanced approach to the basket of incentives and possibly even the creation of outcome-based contracts. It is important to recognize that the desired outcome is a function of the nature of democracy in the country. Distinguishing between levels of democracy, our framework then derives two sets of alternatives based on the nature of alignment and the direction of the technology gap between home and host country.

The framework illustrated in Fig. 2 captures the essence of our argument. The top half of Fig. 2 (Panel A) represents cases where the host country has a high level of democracy. As such, economic outcomes are viewed through the lens of social welfare and the wider sharing of the benefits of growth. The lower half (Panel B), on the other hand, considers cases with lower levels of democracy, and thus, economic development is considered primarily from the perspective of the political elite. Our framework also considers the relative technological advantage of an MNE and the host country, which is a key consideration in the context of FDI, and, given the context of our paper, the extent of geopolitical alignment between the host country and the home country of the MNE.

In Panel A, therefore, the top left cell illustrates the host country's priority when the host country and the home country of the MNE are not geopolitically aligned (i.e., geopolitically divergent), and where the MNEs that the country seeks to attract hold a technological advantage vis-à-vis the host country. The host country's challenge in such a situation is that MNEs are unwilling to transfer their frontier proprietary knowledge to geopolitically divergent countries because of potential technology leakage, or are constrained by policies of their respective home country governments.[23] Therefore, its FDI to the host country is likely to be efficiency-seeking or market-seeking. Given the political pressure on democratic governments to prioritize employment, the host country's optimal policy response is likely to emphasize the gains that can be made by creating skilled employment. Correspondingly, in the top right cell, where the host country has the technological advantage, the priority of the host country may be employment creation,

[22] In effect, we extend the policy discussion about how, for example, host countries may want to generate benefits through supply chain linkages, for example (UNCTAD, 2023).

[23] The CHIPS and Science Act of 2022, which prohibits [semiconductor companies that are recipients of US funding] from expanding semiconductor manufacturing in China and countries defined by US law as posing a national security threat to the United States," is a case in point. (Source: https://www.pwc.com/us/en/library/chips-act.html).

1*Panel A: Democratic Countries*

	MNE has a technological advantage	The host country has a technological advantage
Home and host countries geopolitically divergent	Host country emphasizes skilled jobs	Host country emphasizes employment
Home and host countries geopolitically aligned	Host country emphasizes spillovers within the country	Host country emphasizes local supply chains

Panel B: Non-Democratic Countries

	MNE has a technological advantage	The host country has a technological advantage
Home and host countries geopolitically divergent	Host country emphasizes capital investment	Host country emphasizes exporting
Home and host countries geopolitically aligned	Host country emphasizes knowledge transfer into the country	Host country emphasizes access to GVCs

Fig. 2 Determining host country objectives that underpin FDI policies

more broadly. These priorities would, then, be the *quid pro quo* that the host country would seek from the MNE in return for fiscal and/or other concessions.

When the priority is the creation of skilled employment, the policy focus becomes the employment and development of skilled labor through combinations of incentives and investment in local training schemes. This may include aligning local skills plans with the needs of inward investors, encouraging links between higher education and multinational firms, and subsequently improving labor market flexibility to encourage these skills to permeate into the domestic sector. By contrast, where the priority is the creation of employment, more generally, policy choices would involve linking inward investment policy with regional policy and incentivizing investment to locate in low-employment regions.

In the lower row of Panel A, where the host country and the home country of the MNE are geopolitically aligned, knowledge transfer from the home country is more feasible, with the MNE more confident of IPR protection. The host country can attract technologically advanced market-seeking FDI, with incentives linked to international technology transfer from the parent firm. In the lower-left cell, where the MNE has the technological advantage, the optimal policy response would be to maximize the extent to which this technology transfers into the host economy by maximizing spillovers and formal mechanisms for knowledge transfer. Thus, policy interventions should emphasize the local embeddedness of the inward investors. This, in turn, means using incentives to incentivize knowledge transfer, encouraging buyer-supplier relations and boosting absorptive capacity in the local economy. The fostering of spillovers requires some conditions to be met (see Castellani et al., 2024 for a recent discussion of this), and in contexts with institutional voids, this may also require the development of inclusive institutions that are needed for spillovers (Bhaumik et al., 2019).

Finally, in the lower right cell, where the host country has a technological advantage, and the host country and the home country of the MNE are geopolitically aligned, then the most common form of FDI that will be attracted is technology-seeking FDI which would seek to take advantage of this alignment that makes technology transfer feasible.[24] This type of FDI may not be a priority for countries with technological advantages vis-à-vis MNEs from other countries, and the host country in question is, therefore, unlikely to offer significant (or any) concessions to attract such FDI. To the extent there are benefits associated with this type of FDI, the optimal policy response for the host country may be to maximize engagement between the local SME sector and the MNE, to maximize inter-industry (vertical) spillovers along supply chains by way of integration into local supply chains and linkage of incentives, if any, to

[24] See, for example, the literature on how developing and emerging market firms use linkages with developed countries to strengthen their technological capabilities (Luo & Tung, 2018; Mathews, 2006, 2017).

local content requirements in production, particularly in economically lagging regions. In addition, where the volume of FDI associated with the MNE's projects may be significant, incentives offered to the MNE may be linked to investment in the local innovation ecosystem, e.g., in the case of investment by South Korean MNEs, including Samsung, LG, and Hyundai in southern US states. Indeed, building on these earlier turnkey ventures, South Korea is now the largest single investor in the US in terms of new FDI flows.

We now move to Panel B, where the host country has a political system that is closer to autocracy than to the democracy end of the autocracy-democracy spectrum, and where, therefore, the government, in general, attaches a lower weight to the welfare of citizens or to reducing inequality, and where there are relatively few local vetoes. Starting again with the top left cell, with a geopolitical divergence between the host country and the home country of the MNE, and a technological advantage on the part of the MNE, the nature of the FDI is likely to be market-seeking, with reluctance on the part of MNE to transfer technology to the host country. In such cases, given the relatively low weight attached to the welfare of citizens and relatively less pressure on the government to prioritize employment, the host country is likely to prioritize the dollar value of investment flows. The concessions made to MNEs may include capital incentives linked to the investment value or access to natural resources, and conditionalities may explicitly or implicitly involve sharing the returns with the political elite. Further, the host country may have to provide credible assurances about protecting the property rights of the MNE, perhaps by way of investment treaties. When, by contrast, the host country has the technological advantage, and employment generation and the welfare of the citizens are not necessarily a significant concern, i.e., when we are in the upper right cell, the priority of the host country may be to prioritize macroeconomic factors such as (once again) capital flows and export growth. If the latter is prioritized, the host country would require export promotion policies such as tax incentives linked to export performance or seek trade agreements with key partners.

With higher levels of alignment and the technological advantage held by the MNE, the host country's priority is to maximize knowledge flows from the MNEs. However, in non-democratic (or autocratic) contexts, the compact with the MNE may be such that the benefits of the technology transfer accrue disproportionately to the political elite. The types of FDI attracted here are likely to be market-seeking or resource-seeking, and where the host countries are abundant in natural resources controlled by the political elite, the *quid pro quo* may be technology transfer by the MNE in return for access to these resources.[25] This may be achieved by incentivizing knowledge transfer and mandating entry modes, such as joint ventures, that benefit sections of the elites that disproportionately control the production facilities in the country. By contrast, when the host country has a technological advantage vis-à-vis the MNE, the emphasis in a non-democratic host country may not be on providing concessions to the MNE but on generating rent for the political elite. The host country may, for example, want to leverage inward FDI to better ingrate local firms in sectors over which the political elite have disproportionate control of global value chains (GVCs) controlled by the MNE. It may also encourage collaboration between the MNE with its financial resources and R&D assets in the host country.

To close the loop, the discussion in this section outlines ways a host country may prioritize different outcomes related to inward FDI flow based on a framework encompassing its technological needs, internal political system, and the prevailing geopolitical alignments among countries (Fig. 2). Given these priorities, a host country can decide not just what concessions to make to attract a particular MNE's project and what *quid pro quo* it would seek in advance but also what domestic policies may be required to ensure that the objective underpinning a priority, e.g., the welfare of citizens, is maximized. The host country's decisions about concessions and the *quid pro quo* it seeks, in turn, influence its bargaining with the MNEs with the FDI projects (Fig. 1). Geopolitical alignment plays an important role in the process by influencing both the LOF of MNEs and, hence, the concessions required to incentivize them to invest in a host country and the priorities of the host country by impacting the likelihood of technology transfer.

Conclusion

Geopolitics is once again an important factor in the world of international business. As potential host countries make strategic decisions about whether or not to align with other countries, they simultaneously face the evolution of their outside options. This is because MNEs may be subject to lower legitimacy and, therefore, higher LOF in host countries that are not aligned with their home countries. These developments have been associated with an increasing

[25] For a discussion about the relationship between resource abundance, non-democratic (or autocratic) political systems, and choice of FDI and other policies, see, for example, Asiedu and Lien (2011), Carreri and Dube (2017), Haber and Menaldo (2011), and Ulfelder (2007).

interest in how MNEs with embedded technological advantages can be attracted to potential host countries, especially in the absence of alignment. In addition, there is considerable interest in the purpose served by the associated FDI and whom it would benefit. Industrial policy is very much on the agenda of governments (Evenett et al., 2024), and it is difficult, if not impossible, to disentangle the choices of a host country about its geopolitical alignment (which are often driven by factors such as national security interests) from its policy choices related to FDI.

An important element of our discussion has been to contextualize the nature of FDI policies. This contrasts with the traditional approach, which has focused on the quality of institutions, tax policies, industry clusters, and other factors that can facilitate inward FDI flow and, correspondingly, the location choice of MNEs (Bevan & Estrin, 2004; Nielsen et al., 2017; Sanchez-Martin et al., 2014). As such, we argue that the identified key elements may impose boundary conditions on the policy pathways that potential host countries can choose to attract FDI.

We have sought to link the literature on place-based industrial policy with understanding both firm-level FDI decisions and the importance of international geopolitical factors. For example, we have argued that the ability to attract FDI depends on the outside options of both parties, which in turn is a function of the geopolitical alignment of the firm's home and host countries. The established industrial policy literature tends to bundle these issues under the heading of "conditionality" (e.g., see Bulfone, 2023). We propose a framework that overlays the place-based approach of industrial policy, as expressed in Aiginger and Rodrik (2020), with an understanding of how outside options and geopolitical alignment frame policy. Our framework also highlights the role of the internal political system of a host country in determining its policy choices. In so doing, we capture the nature of MNE–host country interaction in the context of geopolitical alignment (Fig. 1) and demonstrate how international relations, local politics, and the economic interests of countries interact to create potential place-based policy pathways for host countries hoping to attract FDI (Fig. 2).

From the perspective of national policy, understanding geopolitical alignment informs the nature of the inward investment a country can pursue and, importantly, the nature of the global technology that countries can attract. This alignment influences the respective bargaining positions of the two sides. When a home country only has strong geopolitical alignment with a few host countries and geopolitical divergence with many others, this limits the number of potential locations open to a firm and the strategies it may adopt in those locations. So, if that firm seeks to engage in FDI to develop a new technology, it only faces a limited number of locations in which it has a strong bargaining position. In such circumstances, establishing legitimacy and overcoming the LOF may be challenging. In contrast, firms from host countries geopolitically aligned with many other countries or remain non-aligned with geopolitical blocks may observe a much broader set of potential locations and MNE strategies. Hence, that firm's bargaining position in a given location is much stronger, leading to larger policy incentives and greater support from the home government IPAs in establishing legitimacy, particularly regarding access to new technology.

So, what is the response to this? To borrow a well-used phrase, "what you see is what you get." Our framework better informs IPAs as to the type of investment they may be able to attract and how to tailor their offer accordingly. This places the onus on a precise understanding of the benefits that will likely be realized from attracting a given investment and, more importantly, how and whether these benefits are in sync with the local priorities and objectives; as the policy focus shifts from maximizing the flow of FDI to maximizing its returns. Bounded rationality suggests that this may involve focusing on a limited number of sectors and emphasizing complementary policies alongside investment promotion, such as skills development or innovation support. The latter, of course, may be limited by questions of geopolitical alignment. What is clear, however, is that a precise understanding of the expected benefits of a given investment will be required to inform the bargaining position of the host location.

Our analysis raises questions for future research on the links between geopolitical alignment and IB policy. First, we have deliberately avoided discussing the question of exit. An important element of local investment promotion is "aftercare," which ensures that affiliates become embedded and remain in the long term. Geopolitical changes can influence this, such that foreign affiliates' legitimacy may evolve over time. One way of overcoming this may be to assist the foreign firm in finding a local partner or to help them access new markets or new suppliers.

Secondly, our work suggests the need for a greater understanding of the importance of distance more generally for investment policy formulation, particularly in maximizing the benefits of FDI for the local economy. Traditionally, the literature has focused on cultural and social aspects of distance, especially when encouraging MNEs to transfer knowledge to benefit the host economy. Our research also highlights the need to consider political alignment in this context. If political distance plays an important part in the location of knowledge-based assets, and as we note here, there is uncertainty about the importance of such distance, then policy needs to reflect this. Traditionally, this has meant seeking to foster higher levels of embeddedness (Jha et al., 2024) and linking FDI to, say, local skills providers or local innovation ecosystems, which helps establish legitimacy and makes the investment more "sticky".

Our framework and the propositions that follow also lend themselves to both quantitative and qualitative analyses. For example, a multivariate regression analysis may explore how the host country's outside options, its internal political framework, and technological (dis) advantage vis-à-vis MNEs in key industries influence the choice of a government's policy positions regarding inward FDI. For such an analysis, it would be important to bear in mind that the aforementioned factors influence a government's decision about both how it envisages inward FDI to benefit the country and how it plans (or proposes) to share the surpluses generated by the inward investment with the MNEs to help mitigate their LOF. Hence, regression analyses that focus on outcomes of policy choices such as integration of local companies in GVCs following MNE investment (Cadestin et al., 2019) may not capture the full extent of the complexity of inward FDI policies in which multiple objectives may coexist, but one may dominate. Therefore, quantifying a government's policy positions regarding FDI may require sophisticated textual analysis of the type used in other disciplines (e.g., Daniell et al., 2016; Latifi et al., 2024; Laver et al., 2003). And, of course, our framework lends itself to qualitative analyses of inward FDI policies of host countries (Guimon, 2009; Mmieh & Owusu-Frimpong, 2004); however, now in the context of geopolitical alignment.

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